RATING REPORT

Zahra Textile

REPORT DATE:
December 29, 2021

RATING ANALYST:

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RATING DETAILS		
	Initial Rating	
Rating Category	Long-term	Short-term
Entity	A-	A-2
Rating Outlook	Stable	
Rating Date	*December 29, 2021*	

COMPANY INFORMATION	
Incorporated in 2006	**External auditors:** M/s Hussain Associates, Chartered Accountants
Partnership Concern	**CEO:** Mr. Zohair Dilawar Agha
	Managing Partner: Mr. Dilawar Hussain

APPLICABLE METHODOLOGY(IES)
VIS Entity Rating Criteria *Industrial Corporates (August 2021)*
https://docs.vis.com.pk/docs/CorporateMethodology202108.pdf

Zahra Textile

OVERVIEW OF THE INSTITUTION	RATING RATIONALE

OVERVIEW OF THE INSTITUTION

Zahra Textile (ZT) was incorporated in Pakistan in 2006 and operates as a partnership concern. The principal activity of the Company is manufacturing and sale of yarn and manufacturing and sale of brown paper.

RATING RATIONALE

Zahra Textile (ZT) was established in 2006 as a sole proprietorship and later converted into private limited company in 2009. In 2010, the company reverted back to being a sole proprietorship and subsequently in 2013 converted into a partnership concern. ZT is a family owned business. Principal business activity of ZT is spinning however they have a relatively smaller scale manufacturing set-up of paper and paper board. Head office of the Company is located in Karachi with the manufacturing facility located at Nooriabad District Jamshoro, Sindh. The power requirement of the Company is met through gas based generators for Textile segment and through HESCO for Paper and Paper Board segment.

Operations

ZT's core business relates to manufacturing of yarn from a mix of imported and local cotton. ZT has an installed spinning capacity of 16.32m Kgs of yarn. Historically, this unit has been operating at high capacity utilization levels barring FY20 due to COVID-19 led disruption. Yarn count is made as per order requirement and is mostly produced on course counts.

Paper segment produces brown paper which is supplied to packaging industry to produce corrugated box cartons. It has an installed capacity of 36m kg per annum. This unit remained close during FY20 owing to slowdown in paper market.

Key Rating Drivers

Ratings incorporate conservative financial management

Given the highly commoditized nature of business, margins and financial performance of players have depicted volatility due to inherent cyclicality of crop levels and variations in cotton prices. Keeping the cyclicality of the business in view, the management of the company continues to pursue a conservative financial policy aimed towards building a stronger balance sheet footing, enabling the company to weather downturns in the industry. Moreover, diversification into paper and board business, while still a small contributor, aims to provide greater operational efficiency through optimal utilization of power resources. Going forward, emphasis of the Company is to further strengthen liquidity profile through higher retention before any capacity expansion or business integration is pursued.

Positive growth momentum in textile sector lends support to the business risk of the Company.

Textile sector of Pakistan has recorded impressive growth in FY21 and exhibits the same trend in the ongoing year as well. Lifting of Covid-19 led lockdowns, diversion of orders from regional countries facing severe COVID-19 disruption and US-China trade disruption has enabled Pakistan to increase its textile exports. Furthermore, supportive government policies in the form of subsidized utility tariff, low interest rates (Export Finance Schemes), Long Term Financing Facility (LTFF) and Temporary Economic Refinance Facility (TERF) has provided impetus to the textile sector. Hence, the demand for textile products is expected to stay sound in the medium term. Within spinning sector, increase in international prices of yarn in lieu of increasing cotton rate along with inventory gains has helped the sector enhance its margins. Going forward, margins of the spinning sector are expected to stabilize once the low cost inventory is utilized and impact of ongoing higher cotton rates takes effect. Meanwhile, the ongoing fiscal year is expected to see a higher local cotton production vis-à-vis previous year on account of attractive prices available to crop growers and improvement in cotton yield.

Topline of the Company has depicted sound growth over the last three years barring FY20 due to Covid-19 led disruption.

Sales revenue of the Company has grown over the last three years with majority of the revenues comprising of direct and indirect exports. However, sales revenue growth stood muted during FY20 on account of Covid-19 induced slowdown and temporary plant closure within textile unit while operations of Paper and Paper Board were completely shut down. In FY21, sales revenue registered strong growth. Growth in topline was mainly due to higher average selling prices. Client concentration risk in sales is considered manageable. Over the years, Company has developed a sound relationship with its customers. Revenue contribution from paper and board segment remains small while margins also remain thin.

Gross margins improved during FY21 on the back of higher average selling prices and inventory gains.

Gross margins of the Company improved during FY21 on account of higher yarn prices along with timely procurement of raw material. Over the years, low levered balance sheet and adequate working capital resources has allowed the company to pursue an effective procurement strategy. While operating expenses remained under pressure on account of higher freight charges it was offset by improvement in gross margins. Going forward management expects further improvement in margins on account of higher yarn prices, efficient cotton procurement and supported by higher textile demand. Nevertheless, the Company remains exposed to volatility in price of key inputs, ongoing freight issues and higher energy (gas) prices.

Liquidity profile is supported by healthy cash flows

Liquidity profile of the company is considered sound with healthy cash flows in relation to outstanding obligations. Debt servicing capability of the Company is at comfortable levels. Aging profile of trade debt remains satisfactory.

Conservative financial management supports sound capitalization indicators

Historically, low gearing and leverage levels is reflective of Company's conservative financial policies, in support of sound capitalization indicators. Equity base has grown on account of healthy profitability. Debt comprises of mainly short term borrowing for wo working capital requirements Leverage and gearing indicators remain sound.

Corporate Governance offers room for improvement.

Corporate Governance infrastructure in place is reflective of company's operational status as a family-owned partnership concern. Ratings remain constrained due to the organizational status of the company.

Internal audit is outsourced to a third party. Change of auditors to "A" category is expected to strengthen external control and disclosure framework. Functioning of the IT department is considered adequate.

ISSUE/ISSUER RATING SCALE &DEFINITIONS — Appendix II

VIS Credit Rating Company Limited

RATING SCALE & DEFINITIONS: ISSUES / ISSUERS

Medium to Long-Term

AAA
Highest credit quality; the risk factors are negligible, being only slightly more than for risk-free Government of Pakistan's debt.

AA+, AA, AA-
High credit quality; Protection factors are strong. Risk is modest but may vary slightly from time to time because of economic conditions.

A+, A, A-
Good credit quality; Protection factors are adequate. Risk factors may vary with possible changes in the economy.

BBB+, BBB, BBB-
Adequate credit quality; Protection factors are reasonable and sufficient. Risk factors are considered variable if changes occur in the economy.

BB+, BB, BB-
Obligations deemed likely to be met. Protection factors are capable of weakening if changes occur in the economy. Overall quality may move up or down frequently within this category.

B+, B, B-
Obligations deemed less likely to be met. Protection factors are capable of fluctuating widely if changes occur in the economy. Overall quality may move up or down frequently within this category or into higher or lower rating grade.

CCC
Considerable uncertainty exists towards meeting the obligations. Protection factors are scarce and risk may be substantial.

CC
A high default risk

C
A very high default risk

D
Defaulted obligations

Short-Term

A-1+
Highest certainty of timely payment; Short-term liquidity, including internal operating factors and /or access to alternative sources of funds, is outstanding and safety is just below risk free Government of Pakistan's short-term obligations.

A-1
High certainty of timely payment; Liquidity factors are excellent and supported by good fundamental protection factors. Risk factors are minor.

A-2
Good certainty of timely payment. Liquidity factors and company fundamentals are sound. Access to capital markets is good. Risk factors are small.

A-3
Satisfactory liquidity and other protection factors qualify entities / issues as to investment grade. Risk factors are larger and subject to more variation. Nevertheless, timely payment is expected.

B
Speculative investment characteristics; Liquidity may not be sufficient to ensure timely payment of obligations.

C
Capacity for timely payment of obligations is doubtful.

Rating Watch: VIS places entities and issues on 'Rating Watch' when it deems that there are conditions present that necessitate re-evaluation of the assigned rating(s). Refer to our 'Criteria for Rating Watch' for details. www.vis.com.pk/images/criteria_watch.pdf

Rating Outlooks: The three outlooks 'Positive', 'Stable' and 'Negative' qualify the potential direction of the assigned rating(s). An outlook is not necessarily a precursor of a rating change. Refer to our 'Criteria for Rating Outlook' for details.www.vis.com.pk/images/criteria_outlook.pdf

(SO) Rating: A suffix (SO) is added to the ratings of 'structured' securities where the servicing of debt and related obligations is backed by some sort of financial assets and/or credit support from a third party to the transaction. The suffix (SO), abbreviated for 'structured obligation', denotes that the rating has been achieved on grounds of the structure backing the transaction that enhanced the credit quality of the securities and not on the basis of the credit quality of the issuing entity alone.

(blr) Rating: A suffix (blr) is added to the ratings of a particular banking facility obtained by the borrower from a financial institution. The suffix (blr), abbreviated for 'bank loan rating' denotes that the rating is based on the credit quality of the entity and security structure of the facility.

'p' Rating: A 'p' rating is assigned to entities, where the management has not requested a rating, however, agrees to provide informational support. A 'p' rating is shown with a 'p' subscript and is publicly disclosed. It is not modified by a plus (+) or a minus (-) sign which indicates relative standing within a rating category. Outlook is not assigned to these ratings. Refer to our 'Policy for Private Ratings' for details. www.vis.com.pk/images/policy_ratings.pdf

'SD' Rating: An 'SD' rating is assigned when VIS believes that the ratee has selectively defaulted on a specific issue or obligation but it will continue to meet its payment obligations on other issues or obligations in a timely manner.

REGULATORY DISCLOSURES	Appendix III
Name of Rated Entity	Zahra Textile
Sector	Textiles
Type of Relationship	Solicited
Purpose of Rating	Entity Rating
Rating History	(see table below)
Instrument Structure	N/A
Statement by the Rating Team	VIS, the analysts involved in the rating process and members of its rating committee do not have any conflict of interest relating to the credit rating(s) mentioned herein. This rating is an opinion on credit quality only and is not a recommendation to buy or sell any securities.
Probability of Default	VIS' ratings opinions express ordinal ranking of risk, from strongest to weakest, within a universe of credit risk. Ratings are not intended as guarantees of credit quality or as exact measures of the probability that a particular issuer or particular debt issue will default.
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Due Diligence Meetings Conducted	(see table below)

Rating History

Rating Date	Medium to Long Term	Short Term	Rating Outlook	Rating Action
RATING TYPE: ENTITY				
29-Dec-21	A-	A-2	Stable	Initial

Due Diligence Meetings Conducted

Name	Designation	Date
Mr. Muhammad Raza	Chief Accountant	Oct 29th, 2021
Mr. Zohair Dilawar Agha	Chief Executive Officer (Partner)	Nov 10th ,2021
Mr. Zain Dilawar Agha	Partner	Nov 10th ,2021